THE PROFESSIONALS' ACADEMY OF COMMERCE

Auditing

Referral 8 - Solution

Question no 1

Before accepting/continuing an engagement, the group engagement partner shall be satisfied that there is reasonable expectation that sufficient appropriate audit evidence can be obtained for financial information of components.

Where the component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence.

Concern	Group Engagement Team's Response
If group engagement team has serious concerns about competence of component auditor.	Group engagement team will obtain sufficient appropriate audit evidence relating to component without requesting that component auditor to perform work on the financial information of the component.
If group engagement team has less than serious concerns about the component auditor's professional competence (e.g. lack of industry specific knowledge).	Concern may be overcome: • by being involved in the work of the component auditor; or • by performing additional risk assessment or further audit procedures on the financial information of the component.

Question no 2

a) Circumstances under which we would consider the need to use the work of an expert are as follows:
- The valuation of complex financial instruments, land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
- The estimation of oil and gas reserves.
- The valuation of environmental liabilities, and site clean-up costs.
- The interpretation of contracts, laws and regulations.
- The analysis of complex or unusual tax compliance issues.

b) Matters relevant to evaluating the competence and capabilities of an expert include:
- Whether that expert's work is subject to technical performance standards or other professional or industry requirements.

- The relevance of the expert's competence t the matter for which that expert's work will be used, including any areas of specialty within that expert's field
- The expert's competence with respect to relevant accounting requirements that are consistent with the applicable financial reporting framework
- Whether it may be necessary to reconsider the initial evaluation of the competence, capabilities and objectivity of the expert as the audit progresses (because of changes in conditions or results of audit procedures)

c) Considerations when deciding whether to use an auditor's expert may include:
- Whether management has used a management's expert in preparing the financial statements
- The nature and significance of the matter, including its complexity.
- The risks of material misstatement in the matter.
- The expected nature of procedures to respond to identified risks, including the auditor's knowledge of and experience with the work of experts in relation to such matters; and the availability of alternative sources of audit evidence.

Question no 3

a) Objectives of the Internal Audit Department are as follows:
- Monitoring of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
- Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
- Review of compliance with laws and regulations. The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- Risk management. The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.
- Governance. The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

b) For the purpose of determining the extent of reliance that may be placed on the work of internal auditor in specified areas, it may be evaluated by:

i. Inspecting the adequacy of the scope of the work and related programs.

ii. Determining by means of inspection whether the preliminary assessment of internal audit function remains appropriate.

iii. Obtain evidence that:

- The work is performed by staff having adequate technical training and proficiency as internal auditors and the work of assistants are properly supervised, reviewed and documented.
- Sufficient appropriate audit evidence was obtained to serve as a reasonable basis for conclusions reached.
- Conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of work performed.
- Any exceptions/unusual matters disclosed by internal audit are properly resolved.

Question no 4

a)

(i) Materiality is defined as follows:

'Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.'

In assessing the level of materiality there are a number of areas that should be considered. Firstly the auditor must consider both the amount (quantity) and the nature (quality) of any misstatements, or a combination of both. The quantity of the misstatement refers to the relative size of it and the quality refers to an amount that might be low in value but due to its prominence could influence the user's decision, for example, directors' transactions.

In assessing materiality the auditor must consider that a number of errors each with a low value may when aggregated amount to a material misstatement.

The assessment of what is material is ultimately a matter of the auditors' professional judgment, and it is affected by the auditor's perception of the financial information needs of users of the financial statements.

(ii) The situations are stated as below:

- When law, regulation or the applicable financial reporting framework affects users' expectations regarding the measurement or disclosure of certain items (e.g. related party transactions, and the remuneration of management and those charged with governance).
- Key disclosures in relation to the industry in which the entity operates (e.g. research and development costs for a pharmaceutical company or a highly regulated company).
- When attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (e.g. a newly acquired business).

b)

i. Materiality is revised, e.g. if there is

- Change in auditor's understanding of entity and its operations as a result of audit procedures
- Unexpected changes in actual financial statements (as compared to anticipated financial statements)
- Change in circumstances during audit (e.g. a decision to dispose a major part of the business)
- New information

ii. There is an inverse relationship between materiality and the level of audit risk. This relationship is considered by an auditor in determining the nature, timing and extent of audit procedures.
Mr. Iqbal reduced the materiality level which resulted in increase in audit risk. Therefore, in order to compensate the effect of increased audit risk, he should either:

- reduce the assessed risk of material misstatement, where this is possible by carrying out extended or additional tests of control; or
- reduce the detection risk by modifying the nature, timing and extent of planned substantive procedures.

(The End)